

TRADE AND DEVELOPMENT BOARD

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**SG'S AD HOC EXPERT GROUP MEETING
UNLDC IV: KEY DEVELOPMENT CHALLENGES FACING THE LDCS
18-19 FEBRUARY 2010**

**Concluding Summary
by Chair, UNCTAD Inter-Divisional Task Force on UN LDC IV***

UNCTAD has been mandated both by the Accra Accord and General Assembly resolutions to actively contribute to the preparations for the Fourth United Nations Conference on the Least Developed Countries (LDC IV) under the lead role of the United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and the Small Island Developing States (UN-OHRLS). The conference is scheduled to take place during the first half of 2011.

Last fall, an Ad-hoc Interdivisional Task Force has been set up by UNCTAD's Secretary-General with the chairmanship of his Special Adviser on LDCs, to coordinate in close collaboration with the Division of Africa and Least Developed Countries and Special Programmes UNCTAD's substantive inputs for the preparatory process of LDC IV.

In this context, a one-and-a-half day Ad Hoc Expert Group meeting (EGM) was convened by the Secretary-General on 18-19 February 2010 in Geneva addressing key development challenges facing the LDCs. The EGM's discussions will feed into a document UNCTAD is preparing in the run-up to LDC IV.

Presentations of invited panelists and UNCTAD's experts are available on UNCTAD's website at <http://www.unctad.org/Templates/Meeting.asp?intItemID=2068&lang=1&m=18891&year=2010&month=2>

Objectives

The first objective of this expert group meeting has been to improve our understanding of the dynamics which unfolded in the LDCs in the course of the last decade or more. From this point of view, the discussions of the past two days have led to significant improvements

* This conference room paper has not been edited.

in our knowledge about the changes (or lack of them) happening in the LDC economies in the recent past.

The second objective has been to draw some critical lessons and major insights which have come out of the thought-provoking presentations, panel discussions and comments from the floor. We do now have a better appreciation of the key challenges faced by the LDCs, particularly in the post-crisis situation

Rather than doing an exhaustive review of the Brussels' Programme of Action, which had never been one of our goals, we have taken a much more strategic and, possibly, a smarter look at the dynamics of the LDCs' performance during the last decade or so. This meeting was not necessarily about getting recommendations on what LDCs need to do in the future; the explicit purpose was to strengthen our understanding of the past development patterns of the LDCs.

One major consensus resulting from the meeting is that nobody is enthusiastic about repeat of big decadal conferences that would produce non-prioritised long wish list of recommendations. Thus, the solutions to key development challenges facing the LDCs should be looked at in a different way - in terms of design and content as well as in their operational modalities. Having achieved this consensus is, in itself, one step forward as it constitutes the beginning of a new approach on how to deal with the problematique. As we move towards the preparation of LDC IV, this message has to become stronger and more precise and should get more intellectual momentum.

LDCs and Structural Change

Regarding the performance of the LDCs the main points that were raised during the discussion were the following: LDCs' performance has improved during the past decade, but it remains marginal, narrowly-based, fragile and much differentiated. Such an improvement is still very far from what is required in order to catalyze the dynamism experienced by other developing countries that LDCs are aspiring for.

The meeting took note of the situation of LDCs with regard to the legitimate goal of progressing toward graduation from LDC status, in relation to the paramount objective of "structural change". Anchoring the performance assessment on the concept of structural change generated some debates including on appropriateness of similar concepts, e.g. "structural progress" and "structural transformation" were also considered.

It was noted that 10 of the 49 LDCs have been demonstrating significant progress toward graduation thresholds, and that there are 7 more potential graduation cases in the long run. These add to the current three graduation cases (Equatorial Guinea, Maldives, Samoa), while nearly 60% of all LDCs (29 out of 49) do not foresee graduation in any near future. The experts noted that while genuine structural progress is likely to induce progress toward graduation thresholds sooner or later, the reverse is not necessarily true (indeed often debatable) as can be seen with the highly vulnerable countries that are or have been in the

process of losing LDC status. Structural progress, a dynamic notion in essence, is relevant and important to all LDCs irrespective of their performance under graduation borders.

The need for better understanding of the interrelationship between the LDCs' graduation criteria, the MDGs and structural change was also emphasized. It was recognized that the three move in the same direction. The question is whether they all move in tandem or there is a sequence whereby one follows the other. Notwithstanding the large improvements in meeting the MDGs and in implementing structural change, the issue of graduation, and related criteria, deserves further attention.

Another lesson that has come out clearly from the meeting is the issue of differentiated growth. The existing heterogeneity in the LDC group is expressed in the different endowments that countries have (initial conditions) and also in the performance and in the mix of policies adopted. Undoubtedly, the initial conditions determine a part of the overall performance, while the remaining part is explained by the dynamics and the implementations of the policies adopted. This issue of heterogeneity has come up mostly in relation to the different performance experienced by Asia and Africa and by oil exporters/manufacturing exporters vs. agricultural exporters. At the same time, however, this broad dichotomy between Asia and Africa may not hold; in the case of Lesotho, for example, a small country was able to undertake a large structural transformation from an initial agro-pastoral specialization into becoming a manufacture exporter.

When dealing with the common structural handicaps facing the LDCs, it was pointedly argued that we have to be sensitive to the individual needs of these countries.

Trade Performance

LDCs' continue to remain at the margins of international trade. LDCs' share of global trade in goods and services increased from 0.57% in 2001 to 0.83% in 2008, and the share of goods alone rose from 0.58% to exceed 1% in 2008 for the first time in many decades. LDCs' share of services trade remains stagnant at 0.5% despite an expansion in value terms. LDCs' share of South-South merchandise trade rose from 1.7% to 2.4% during the same time period. Exports of LDCs contracted following the global financial and economic crisis, but they have recently shown some signs of recovery.

LDC's trade performance remains fragile as it is based on a very narrow export base, primarily commodities, which increases the vulnerability of LDCs to external economic shocks. LDCs experience persistent current account deficits during the decade, denoting high dependence on imports for consumption and industrial development. LDCs remain extremely vulnerable to climatic and natural shocks, as exemplified by the situation in Haiti.

The importance of market access for LDCs has provoked a major debate. It was recognized that, although important, market access is not enough. Having efficient supply-side capacity is equally important. There is a need to strengthen the economic resilience of LDCs by way of assisting them in diversifying production and increasing their value added. LDCs should be assisted in producing and trading in sectors/products/services of

international trade that show dynamic growth potential and are pro-poor, high income generating and environmentally friendly. Services sector development and trade such as tourism, movement of service suppliers and IT-related services constitute important drivers for such transformation. Regional integration and South-South trade are especially important to LDCs in helping them diversify their production and markets.

The analysis of LDCs trade also needs to look at the effectiveness of the preferential market access schemes and issues, such as, rules of origin, non-tariff measures and product standards. Flow and composition of Aid for Trade to LDCs deserve special scrutiny, particularly in terms of its contribution to building trade supportive infrastructure.

State of Investment Promotion

The discussions highlighted the important role of FDI for the LDC economies: the share of FDI as a percentage of the domestic investment is equal to some 33 per cent, against some 13 percent in developing countries on average, and has exceeded bilateral ODA since 2004 to become the most important resource flows to LDCs. However, FDIs are largely concentrated in selected industries and countries. The bulk of it is in extractive industries particularly in Africa and in services and telecommunication in Asia.

There were discussions regarding how much FDI may complement or even substitute the formation of capital by domestically-owned firms. FDIs in the LDCs have been found to also go for mergers and acquisitions, rather than Greenfield investments.

The "crowding in" effect of the FDIs inflows in the LDCs occurs through the fostering of domestic investment, but also through the linkages that are subsequently created with the rest of the economy. It is this dynamism in catalyzing the domestic comparative advantage that increases the benefits associated with foreign investment. The promotion of the linkages between foreign and domestic enterprises has remained a challenge in LDCs. Differences in the effects of FDI on domestic investment among countries suggest that national development strategies and investment policies including linkages between foreign affiliates and domestic firms should be coordinated to ensure maximization of synergies between FDI and domestic investment.

Aside from capital inflows, FDI brings along the benefits of technology, know-how, access to international markets and integration into global value chains led by TNCs. Therefore FDI needs to be more effectively tapped and attracted by LDCs to build up their productive capacities and comparative advantages. However, attracting FDI by small and poor countries has not been easy. In 2008, LDCs collectively attracted less than 1% of the world FDI stock. The domestic legal framework and the bilateral investment agreements have been recognized as being valuable, but insufficient to attract FDIs. Countries need to improve their investment climate constantly for both domestic and foreign investors. Policy-makers need to facilitate linkages with local businesses and nurture their capabilities to take advantage of FDI.

FDI cannot lead economic growth, though it helps countries to grow further. In this respect LDCs could more effectively utilize market-access measures as the EU's Everything But Arms and United States' African Growth and Opportunity Act (AGOA) initiatives. For the LDCs' part, however, it is essential that they build and foster domestic capabilities in physical infrastructure, production capacity and institutions supportive of private investment to strengthen the necessary linkages between TNCs' export sectors and the rest of the economy and be part of their global value chain.

Commodities

Over the past decade, LDCs have become increasingly commodity dependent. This increasing importance of primary commodity exports relative to manufactured exports is the result of the unprecedented increase in the prices of commodities during this period (rather than increases in export volume). This development has therefore exposed their export earnings to price volatility thereby exacerbating their vulnerability. The commodity boom has had differentiated effects on different groups of LDCs. The boom has been beneficial to the net commodity-exporting LDCs (especially those exporting fuels), although it has raised issues regarding the management of the windfall income so that it contributes to sustainable development and poverty reduction. On the contrary, it has created balance of payments problems for those LDCs that are net fuel or food importers. Most of these LDCs have accumulated huge fiscal deficits as a result of the spike in food prices during 2008.

The importance of the agricultural sector in LDCs in terms of its contribution to GDP, and employment, and its potential for poverty reduction was noted, although it was recognized that the sector does not attract resources commensurate with its actual and potential contribution. There was a consensus to devote more resources to the sector in order to increase productivity, efficiency and output.

During the discussions, other issues came up as being particularly important for the LDCs, namely the *problematique* of natural resources, and the importance of good governance to ensure that natural resource rents are well managed. The need to address "market entry" barriers was underscored, in particular because domestic policies for export diversification are less likely to succeed without complementary action at the multilateral level to address these constraints.

Transport, Trade Facilitation, Technology and Innovation

Persistent economic inequality coupled with a lack of access to information, education and training result in an entrenched lack of capacity in many LDCs to absorb, adapt and use science and technology and hence to innovate. Access to ICTs, in particular the number of mobile phone subscriptions, has been one of the most positive developments in LDCs. Unfortunately in other areas such as the broadband internet LDCs still lag behind.

The importance of trade facilitation was illustrated by the case of Benin. LDCs in their efforts to better integrate in the globalized production and trade flows have to strengthen their productive capacity and the competitiveness of their economies and products. To achieve this, the supply chain needs to be improved and costs and time associated with trade transactions reduced.

It was largely recognized that poor infrastructure is a heavy constraint to the growth prospect of the LDCs. Improvements in the infrastructure stock and in infrastructure services are therefore key for LDCs. Improvements should not only cover the building of highways, roads, telecommunication, but also investment in energy and electricity-producing plants. Energy was perceived as being a major, although missing issue, in the debate.

South-South Cooperation

During the past decade, there have been changes in the global scenarios due to emergence of the global South. This global South has become one of the main players with respect to FDIs, merchandise and service exports, technological flows and as a holder of IPRs. Some key countries that belong to this group have moved from being debtor countries into being creditor countries. The LDCs have a lot to gain from exploiting this form of development originating from South-South cooperation.

The discussions in this session led to many questions: Is there adequate understanding of this new South-South cooperation? Is there sufficient transparency? Are they really harmonized in the light of the international best practices in terms of standards that have been established?

Macroeconomic Framework

Although economic growth in LDCs has been strong over the past decade, considerable pitfalls to economic development have prevailed and their effects been amplified by the current global financial crisis.

A much-debated issue has been the various conditions conducive to economic growth in LDCs. In particular, real interest rates have been deemed excessively high in LDCs compared to other developing countries, thereby prohibiting investment and ultimately economic growth. As a rule of thumb, real lending interest rates should equal the rate of economic growth; empirically, however, they would seem to be about 10 per cent too high given this rule. This might be due to market failure and lack of competition in the credit market. Moreover, many LDCs have seen their ability to borrow compromised due to a more restrictive borrowing framework, even though their economies ran on solid foundations. The paramount importance of interest rates for investment was questioned by another panelist. Cross-country evidence was evoked that would show that GDP growth is mostly linked to growth in total factor productivity, a concept which pertains to economic efficiency.

Therefore, factors other than interest rates such as the business climate, political stability and government efficiency, as well as infrastructure might play an even more important role than interest rates.

The panelists concurred on the importance of official development assistance (ODA) for LDCs. There has been agreement that foreign aid will continue to be crucial for some countries, especially in the crisis. In a broader view of capital flows, foreign aid remains the major source of income for most LDCs. The increasing importance of private donors and emerging countries has been highlighted. These emerging donors in particular complement aid flows of traditional donors that have been less active in infrastructure investment in favor of expenditure related to the MDGs. In the discussion, panelists and commentators alike highlighted the need to keep up with ODA commitments to LDCs even in the wake of the crisis which already caused a number of major donors to disburse less. In light of the crisis, the panelist suggested to "getting the analytics right" in order to use scarce development funds in the most effective way.

Major debt indicators of LDCs have improved throughout the past ten years. This can be attributed to the multilateral debt relief initiatives (HIPC and MDRI), which nonetheless soon are coming to an end, and to the commitment of emerging donors at the debt relief front. The panel discussed ways to support LDCs in the issue of debt, for example through debt moratoria, better debt management and better rules for responsible lending and borrowing.

The discussion showed that the crisis has put at risk the achievements in development finance of the previous years. Participants shared country experience on the multi-channel impacts of the current crisis. Accordingly, improved market access for LDCs as well as the preservation of tariff revenue for obtaining fiscal space, have been deemed critical.

Way forward

Admittedly, there is no one solution, just a combination lock, where each country will have to find its unique combination number. Development strategies cannot therefore be conceptualized only at the broad level, but they need to take into account the individual country specificities that characterize each one of them. However, a rigorous retrospective analysis can provide good guidance towards articulating future development practices.

In drafting its report, the UNCTAD Inter-Divisional Task Force on LDC IV will take on board the comments and suggestions put forwards by the experts at the EGM. The draft will be shared with the panelists in April 2010 for their feedbacks. The Task Force report will provide the substance for discussions by the Member states that are to take place in June 2010 at the executive session of the TDB on LDC IV. Finally, the document will be fed into the preparatory process for LDC IV that is being spearheaded by the OHRLLS.